Corporate & Commercial and Projects & Energy

ALERT | 12 June 2024

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SOUTH AFRICA

Reform of the electricity market: Updates on the ERA Bill and draft Wholesale Market Code

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Reform of the electricity market: Updates on the ERA Bill and draft Wholesale Market Code

South Africa's energy sector is historically founded upon a vertically integrated model in terms of which Eskom has been responsible for electricity generation, transmission and distribution. However, the ongoing electricity supply crisis has accelerated calls and action to reform the market to provide for greater private access and a more competitive multi-market system.

Key to this process is the Electricity Regulation Amendment Bill [B23B-2023] (ERA Bill) and associated regulatory instruments that will, once enacted, inform both the unbundling of Eskom and the overhaul of the applicable regulatory framework as is currently provided for under the Electricity Regulation Act 4 of 2006 (ERA).

This alert highlights recent developments in respect of the ERA Bill and associated draft Wholesale Market Code (Draft Code).

ERA Bill

Following its release for public comment in February 2022, the ERA Bill was tabled in Parliament on 23 August 2023. This commenced the constitutional legislative process in terms of which the ERA Bill was considered by the National Assembly and National Council of Provinces (NCOP), with further opportunity provided for public consideration and submissions. The ERA Bill was recently passed by the NCOP, on 16 May 2024, and sent to the President for assent.

The ERA Bill contemplates a multi-market system, which is defined as a hybrid market model designed to accommodate various defined transactions (market transactions, physical bilateral transactions and regulated transactions). It further seeks to ultimately establish an independent transmission system operator (TSO) that will assume the role of System Operator, Market Operator and Central Purchasing Agency.

Importantly, the ERA Bill only provides the framework to reform the energy sector in South Africa. Therefore, a lot will remain dependent on the formulation and implementation of other regulatory mechanisms, including sector policies, regulations and various market codes.

Draft Wholesale Market Code released for comment

On 19 April 2024, Eskom launched the Draft Code for public comment. As stated by Eskom, the Draft Code is *"an integral part of the new electricity supply industry"* that is envisaged under the ERA Bill and will *"inevitably shape South Africa's future"*.

The Draft Code was launched together with the South African Wholesale Market Specification (Specification) compiled by the National Energy Crisis Committee (NECOM), which serves to *"support the understanding of the South African multi-market model as defined in the ERA Bill"*.

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Consultation workshops hosted by NECOM are underway, with comments on the Draft Code due by 30 September 2024. During the first workshop hosted on 8 May 2024, it was well summarised that the intention of the Draft Code is to allow for competition within the market through power exchanges where prices are set on a short-term basis. This will be achieved by establishing platforms that will cater for the flow of information (in respect of generation and demand) so as to better facilitate the trade of electricity in South Africa.

While it remains a highly technical document, we set out the main features of the Draft Code below as it pertains the proposed restructured multi-market model in South Africa and associated key role players.

Key multi-market platforms

The Draft Code essentially provides for four key platforms that relate to the physical delivery of energy that will make up the larger hybrid multi-market model, including the Day Ahead Market, Intra-Day Market, Day Ahead Energy Reserve Market and Balancing Market.

The Day Ahead Market will require day-ahead declarations by generators and consumer representatives (i.e. retailers, brokers and traders) to allow for day-ahead forecasting of energy demand and supply. The Intra-Day Market will, in turn, allow for adjustment of declarations as matters progress closer to real time, essentially providing opportunity to avoid exposure to the Balancing Market.

Any resulting imbalances arising in real time due to any differences between real and predicted supply and demand can be reconciled through the remaining market platforms. Here, the Day Ahead Energy Reserve Market will provide a dynamic platform where the intention is to cover any shortfall in real time by generators offering reserves and consumers declaring reduced consumption. The Balancing Market will then ultimately require balance-responsible parties to settle the costs for any imbalance caused by the difference in real and predicted supply or demand. The Draft Code is rather complex in terms of the different forms of balancing that can occur, but the ultimate purpose is to account for resources expended by the System Operator to manage any imbalances in real time.

Ancillary services and additional platforms, including those providing for financial energy markets, will be developed in future as the market becomes more sophisticated.

Key stakeholders

National Energy Regulatory of South Africa (NERSA)

NERSA will assume the role of administrative authority in respect of the Draft Code, ensuring industry implementation and compliance. Its functions will include *inter alia* certifying balance-responsible parties and establishing conditions for approval to participate in the market.

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National Transmission Company of South Africa (NTCSA) and its many hats

As contemplated under the ERA Bill, one of the main components central to the unbundling of Eskom and the new multi-market structure is the establishment and operationalisation of the NTCSA. After a five-year transitional period, the NTCSA will be replaced by an independent TSO.

The NTCSA, and ultimately the TSO, will wear many hats under the new multi-market regime including that of System Operator, Market Operator and Central Purchasing Agency (CPA). Per the Specification, each of these entities will assume specific roles in the functioning and transition of the market, namely:

- System Operator: It will be responsible for the "*metering of all market participants, the real-time balancing of supply and demand on the integrated power system, and the issuing of dispatch instructions.*"
- Market Operator: It will be responsible for "*managing the market platform(s) and for ensuring that financial settlements between buyers and sellers are settled in a fair, neutral and transparent manner.*"
- Central Purchasing Agency (CPA): It will be "*a market support entity fulfilling the role of counterpart to the contracts necessary to facilitate the transition to a competitive market, as well as managing non-market agreements or services to enhance the functionality of the market.*" The CPA will be a special purpose vehicle within the NTCSA.

The Draft Code and Specification both further elaborate on the functions and activities of these entities.

Key considerations

While South Africa's energy sector is evidently being restructured in its entirety, it is important to note that these changes cannot be implemented overnight. Certain key considerations, some of which have been highlighted below, have been discussed and catered for in an attempt to ensure a fair transition over time.

Eskom market dominance

As part of its role to support the transition, the CPA will conclude power purchase agreements (PPAs) with Eskom in respect of its existing fleet of power stations, which are referred to as "*vesting contracts*". This will, in turn, ensure that the market and the prevailing market electricity price remain protected from Eskom dominance.

Legacy PPAs

The CPA will also function as the buyer in respect of legacy PPAs procured, or in the process of being procured, by virtue of section 34 determinations under ERA. Importantly, the terms of such PPAs will remain unchanged and will not be exposed to the market, as the CPA will assume such risk. The CPA will therefore provide forecasts based on generators' projections and take on balance responsible accountability in respect of any deviations.

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Existing bilateral PPAs

As participation in the market is ultimately voluntary, existing private or bilateral PPAs will remain unaffected. That being said, the introduction of the Balancing Market requires accountability from parties to bilateral PPAs for forecasting and deviations. It was confirmed during the first NECOM consultation workshop that while the Balancing Market will thereby mitigate risk for imbalance, it ultimately needs to steer clear of becoming too punitive or uncertain so as to disincentivise investment in private generation.

Municipal participation in market

There are some concerns over the Draft Code not adequately catering for the role of municipalities and their ability to participate in the market. Feedback during the NECOM workshop highlighted that, while the Draft Code could be improved in this respect, its purpose must not be misconstrued. The potential impediments stemming from municipalities' poor financial standing with Eskom is a long-standing issue and while it needs to be addressed, it falls outside the ambit of the Draft Code.

Renewable Energy Certificates (RECs) market will have to become more sophisticated

Since the market will ultimately be made up of energy generated by a variety of sources, there is concern over the ability to track and claim the benefits of consuming electricity generated by cleaner energy resources, including renewable energy projects. It is generally acknowledged that South Africa will therefore have to develop a more sophisticated market for the governance and trading of RECs.

Way forward

As explained during the launch of the Draft Code, there are certain critical steps that need to be taken as part of the overhaul of the South African electricity market, including:

- promulgation of the ERA Bill, which will likely be delayed pending resolution to the outcome of the recent government elections;
- establishment of the NTCSA, which is set to commence trading on 1 July 2024;
- finalisation of the Draft Code, which is to be submitted to NERSA for approval;
- establishment of a Market Operator within the NTCSA;
- complete unbundling of Eskom, including the generation and distribution arms; and
- implementation of a national wheeling framework.

Emphasis was placed on the fact that development of the Draft Code is an ongoing process through which continuous changes will be implemented to cater for stakeholder input and concerns. Workshops are set to continue until September 2024, with the aim being to submit the Draft Code to NERSA by November 2024.

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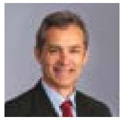

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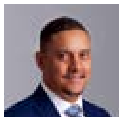

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Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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